

## **FY 2019 Market Dominant Product Incremental Costs**

**Note:** Revisions of 1/10/20 described at end of Preface in **bold**.

### **I. PREFACE**

#### **A. Purpose and Content**

USPS-FY19-43 provides incremental cost estimates for market dominant products and classes for FY 2019, along with supporting documentation. Consequently, it also provides the inframarginal cost estimates by product necessary to implement the expanded definition of attributable costs adopted by the Commission in Docket No. RM2016-13, Order No. 3641 (December 1, 2016).

#### **B. Predecessor Document**

The direct predecessor for this folder in last year's ACR was USPS-FY18-43. In ACR dockets before Order No. 3641, materials regarding incremental costs for competitive products (but not market dominant products) appeared in folder NP10 (e.g., in Docket No. ACR2015, USPS-FY15-NP10). Previously, materials on incremental costs were filed in omnibus rate cases, most recently the testimony of witness Pifer (USPS-T-18) in Docket No. R2006-1.

#### **C. Corresponding Nonpublic Document**

The corresponding nonpublic document, presenting incremental cost materials for competitive products is USPS-FY19-NP10, although additional material on incremental costs for competitive NSA products appears in USPS-FY19-NP27.

#### **D. Methodology**

USPS-FY19-43 applies essentially the same basic methodology as applied in the FY 2018 ACR with respect to market dominant products in USPS-FY18-43, and with respect to competitive products in USPS-FY18-NP10. That methodology includes the modifications mentioned by the Commission in Order No. 3506 to allow the previously-approved group-level incremental cost model to calculate class-level and product-level incremental costs.<sup>1</sup> As was done last year (and all years since the issuance of Order No. 3641), the model from USPS-FY15-NP10 has been modified to produce the class-level and product-level incremental costs, and has been applied to market dominant products in this folder.

The USPS-FY15-NP10 methodology was developed in Proposal 22, Docket No. RM2010-4 (approved by the Commission on January 27, 2010 in Order No. 399). As indicated in Proposal 22, the calculation of incremental costs, including any

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<sup>1</sup> Docket No. RM2016-2, Order No. 3506 (September 9, 2016) at page 60.

group specific costs, is based on the methodology presented by witness Bradley and implemented by witness Kay in Docket No. R2000-1.<sup>2</sup> The methodology was successfully implemented in subsequent rate cases as well, such as Docket No. R2001-1 and Docket No. R2005-1.<sup>3</sup>

As indicated in Proposal 22, this methodology builds up from cost estimates developed at the cost pool level, and thus can only be applied directly to products for which product-specific data are available at the cost pool level. Proposal 22 (October 23, 2009) at 2-3. Proposal 22 noted that cost pool information is not available for international products (*id.* at 3-4), and therefore the methodology has historically been applied only to domestic products.<sup>4</sup> Consistent with the current limitations identified in Proposal 22, the best available estimate of the FY 2019 incremental costs for each international market dominant product is simply the sum of the volume variable costs and the product specific costs for that product. Since the public portion of those international costs are already shown in the public CRA in USPS-FY19-1, they are not reproduced here.<sup>5</sup>

Two notable improvements in the incremental cost methodology first introduced in FY 2017 continue to be applied. The first improvement allowed the group of competitive international products to be directly included when incremental costs are estimated for the overall group of all competitive mail products. The second improvement relates to NSA products, and employs a proxy measure to

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<sup>2</sup> See, Direct Testimony of Michael D. Bradley on Behalf of the United States Postal Service, Docket No. R2000-1, USPS-T-22; and Direct Testimony of Nancy R. Kay on Behalf the United States Postal Service, Docket No. R2000-1, USPS-T-23.

<sup>3</sup> See Direct Testimony of Nancy R. Kay on Behalf the United States Postal Service, Docket No. R2001-1, USPS-T-21 and Direct Testimony of Nancy R. Kay on Behalf the United States Postal Service, Docket No. R2005-1, USPS-T-18.

<sup>4</sup> The Commission acknowledged these circumstances in Order No. 3641(Docket No. RM2016-13, December 1, 2016) at 6.

<sup>5</sup> The absence of inframarginal cost estimates for market dominant international mail products might be viewed as more troubling if there were reason to believe that such estimates (if available) might be material, but that is not the case. This conclusion is based on the magnitude of the inframarginal costs obtained when estimating group incremental costs for the entire group of market dominant international mail. As shown in Table 1 on page 7, those results indicate that inframarginal cost estimates for the entire group would appear to be a very small fraction of volume variable costs, somewhere in the neighborhood of 0.1 percent. For individual products within the group, that fraction would be even smaller. Consequently, while it would be ideal to have incremental costs for each individual international product, the current inability to generate such estimates (and thus alternatively to rely simply on the sum of volume variable and product specific costs) does not result in any material understatement of attributable costs for those products.

substitute for actual cost-pool level data, using this to provide an estimate of product-level inframarginal costs. The same proxy procedure is applied to both market dominant (if any) and competitive “product types” that contain domestic NSA products, although only the market dominant calculations (if there were any) would be presented in this folder. The same proxy procedure is also applied to derive separate inframarginal cost estimates for the market dominant and competitive portions of Post Office Box Service and for the Non-Profit approximations that are presented in USPS-FY19-27. The Post Office Box approximations are shown in USPS-FY18-NP10 and the Non-Profit approximations are found in this folder. Further details on these two earlier improvements (which were approved by the Commission on July 19, 2018 in Order No. 4719 in Docket No. RM2018-6) can be found in the Preface to USPS-FY18-43.

The available incremental cost information regarding Market Dominant products is summarized in the Excel file **IC2019Public.ICSummaryRpt.Rev.01.10.20.xlsx**, and is also reproduced at the end of this Preface.<sup>6</sup> The results start with a column (Column 4) showing the product-level and class-level incremental costs generated by the existing model. By necessity, however, this model uses as inputs volume-variable costs *before* any final adjustments. Therefore, additional columns are presented showing the final adjustments, and then adding those final adjustments to the model-based incremental costs. Note that the final adjustment for Post Office Boxes removes the volume variable cost of competitive Post Office Box Services, but the inframarginal cost is for the entirety of Post Office Box Services. Displayed at the end of this document are the inframarginal costs for market dominant Post Office Boxes generated by the cost driver approximation analysis, as well as the inframarginal costs for market dominant NSAs. (The actual calculations of the Post Office Box inframarginal costs, however, are presented in the Special Analyses folder of USPS-FY19-NP10.)

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<sup>6</sup> Incremental costs are presented in some rows containing multiple products (e.g., Total Single-Piece Letters and Cards, Total First-Class). As postal witnesses have repeatedly stressed (see, e.g., the Direct Testimony of Nancy R. Kay, USPS-T-21, Docket No. R2001-1, at page 20), the incremental costs of a group of products will be different from the sum of the incremental costs of the individual products within the group. As she explains in that testimony, this occurs because of how the total amount of the cost driver associated with the volume of the entire group is removed when calculating the aggregate group incremental costs. Readers therefore should not expect that the *incremental* costs shown in rows in this folder presenting results for multiple products will equal the sum of the *incremental* costs shown in the rows for the constituent products aggregated in that row.

Finally, as was done last year, Excel file **IC2019Public.NewAttribCRpt.xlsx** shows attributable and institutional cost at the component level, as directed by the Commission in the FY2017 ACD (March 29, 2018) at page 10.

## **E. Input/Output**

The inputs for the primary calculation of the incremental costs for domestic products are from the FY 2019 CRA Model (Model Files, Cost Matrices, and Reports), USPS-FY19-31, and FY 2019 CRA “B” Workpapers, USPS-FY19-32. This year, there are no inputs for market dominant NSAs to be obtained from USPS-FY19-30.

The outputs are the inframarginal costs used as a component of the attributable costs appearing in the CRA Reports (USPS-FY19-1 and USPS-FY19-NP11), for Non-Profit USPS Marketing Mail in USPS-FY19-27, and for domestic market dominant NSA products (if there were any) in USPS-FY19-30.

## **II. ORGANIZATION**

The Incremental Cost (IC) Model is filed as USPS-FY19-43.zip. The zip file contains four folders with the files needed to use the IC Model:

- Documentation – Reference Files
- Programs – Program Files
- Model – Input and Output Files
- Special Analyses – All files used to estimate the incremental cost for market dominant NSAs and Non-Profit USPS Marketing Mail.

The Documentation folder contains two files. The files in this folder and their functions are as follows:

- ICRunInstructions.doc – Instructional Document
- CostPoolsFY2019.xlsx – Input Cost Pool Data (added to FY2019Public.ComboOutputMatrix.xlsx)

The Programs folder contains the two program files:

- IC.Model.xlsm – IC Model run module
- IC.DIM.xlsm – IC Model data input module

The Model folder contains three input files needed to replicate Domestic Competitive Incremental Cost:

- FY19Public.ComboOutputMatrix.xlsx – Fiscal Year 2019 public CRA OutputMatrix with added international market dominant and costpools.
- IC2019Public.cntl.xlsm – Incremental Cost 2019 control tables
- IC2019Public.PS.xlsx – Incremental Cost 2019 product specific

The Model folder also contains five output files that are a result of the model's run:

- IC2019Public.CRpt.xlsx – IC C (Cost Segments and Components) Report
- IC2019Public.ICSummaryRpt.xlsx – IC Summary Report
- IC2019Public.PSRpt.xlsx – Group Product Specific Report
- IC2019Public.CP.xlsx – Cost Pool calculation workbook
- IC2019Public.IC.xlsx – IC calculation workbook
- IC2019Public.NewAttribCRpt.xlsx – Attributable and institutional cost by component

The Special Analyses folder contains all of the program and model files used in the estimation of incremental cost for market dominant NSAs (if there were any) and the non-NSA portion of the relevant products, and the Non-Profit portion of the relevant products. The NSA and non-NSA portion of market dominant products is used in USPS-FY19-1, market dominant NSA incremental costs (if there are any) are used in USPS-FY19-30, and non-profit incremental costs are used in USPS-FY19-27. The IC.Model.xlsm and IC.DIM.xlsm have been set up with the correct options and mail class list to use for this run.

- IC.Model.xlsm – IC Model run module
- IC.DIM.xlsm – IC Model data input module
- FY19.OutputMatrixMD\_NonProfit.xlsx – Fiscal Year 2019 CRA Output Matrix with development of cost share percentages for market dominant NSA and Non-Profit
- IC2019Public.cntl.xlsm – Incremental Cost 2019 control tables
- IC2019Public.CP.xlsx – Cost Pool calculation workbook
- IC2019Public.IC.xlsx – IC calculation workbook
- IC2019Public.CRpt.xlsx – IC C (Cost Segments and Components) Report
- IC2019Public.ICSummaryRpt\_NonProfit.xlsx – IC Summary Report for market dominant NSA and Non-Profit.

**Table 1. IC Summary Report for Market Dominant Products and Total Competitive**

<i>Component Name</i>		Vol Var / Prod Spec Cost	Group Product Specific	Inframarginal	Incremental Cost	Final Adjustments	Incremental Cost with Final Adjustments
<i>Source/Notes</i>		USPS-FY19-31 USPS-FY19-NP4	USPS-FY19-NP10 USPS-FY19-NP2	Col.4 - (Col. 1 + Col. 2)		USPS-FY19-31 D Report	Col. 4 + Col. 5
Columns		(1)	(2)	(3)	(4)	(5)	(6)
<b>MARKET DOMINANT PRODUCTS</b>							
<b>First-Class Mail</b>							
Single Piece Letters	3	5,098,527	0	174,165	5,272,692	0	5,272,692
Single Piece Cards	4	185,844	0	873	186,718	0	186,718
Total Single Piece Letters and Cards	5	5,284,371	0	193,124	5,477,495	0	5,477,495
Presort Letters	8	4,615,642	0	62,463	4,678,105	0	4,678,105
Presort Cards	9	173,140	0	173	173,313	0	173,313
Total Presort Letters and Cards	10	4,788,782	0	69,775	4,858,557	0	4,858,557
Flats	14	1,513,175	0	2,786	1,515,961	0	1,515,961
<b>Total First-Class</b>	<b>80</b>	<b>11,586,328</b>	<b>0</b>	<b>503,286</b>	<b>12,089,614</b>	<b>0</b>	<b>12,089,614</b>
<b>USPS Marketing Mail</b>							
High Density and Saturation Letters	21	604,782	0	3,910	608,691	-22,968	585,723
High Density and Saturation Flats and Parcels	22	1,450,843	0	24,892	1,475,735	22,968	1,498,703
Every Door Direct Mail Retail	24	46,105	0	55	46,160	0	46,160
Carrier Route	23	1,664,694	0	8,572	1,673,266	0	1,673,266
Letters	25	5,007,362	0	116,793	5,124,154	0	5,124,154
Flats	26	2,301,296	0	5,287	2,306,583	0	2,306,583
Parcels	27	84,904	0	8	84,912	0	84,912
<b>Total USPS Marketing Mail</b>	<b>81</b>	<b>11,159,985</b>	<b>0</b>	<b>637,957</b>	<b>11,797,942</b>	<b>0</b>	<b>11,797,942</b>
<b>Periodicals</b>							
In County	31	96,239	0	35	96,274	0	96,274
Outside County	32	1,763,950	0	4,695	1,768,645	0	1,768,645
<b>Total Periodicals</b>	<b>82</b>	<b>1,860,189</b>	<b>0</b>	<b>5,342</b>	<b>1,865,530</b>	<b>0</b>	<b>1,865,530</b>
<b>Package Services</b>							
Alaska Bypass	45	20,361	0	0	20,361	0	20,361
Bound Printed Matter Flats	42	132,825	0	32	132,857	0	132,857
Bound Printed Matter Parcels	43	296,422	0	257	296,679	0	296,679
Media and Library Mail	44	396,076	0	965	397,042	0	397,042
<b>Total Package Services</b>	<b>83</b>	<b>845,685</b>	<b>0</b>	<b>2,085</b>	<b>847,770</b>	<b>0</b>	<b>847,770</b>
<b>U.S. Postal Service</b>	<b>85</b>	<b>305,481</b>	<b>0</b>	<b>71</b>	<b>305,553</b>	<b>-305,481</b>	<b>71</b>
<b>Free Mail</b>	<b>86</b>	<b>39,843</b>	<b>0</b>	<b>2</b>	<b>39,846</b>	<b>0</b>	<b>39,846</b>
<b>Special Services</b>							
Ancillary Services							
Certified	51	471,525	0	6,907	478,433	0	478,433
COD	52	2,514	0	0	2,514	0	2,514
Insurance	54	41,442	0	19	41,461	0	41,461
Registered Mail	55	16,765	0	2	16,768	0	16,768
Stamped Envelopes	56	9,423	0	8	9,431	1,173	10,604
Stamped Cards	57	178	0	0	178	0	178
Other Ancillary Services	58	244,377	0	2,885	247,261	0	247,261
Address Management Services	61	6,248	0	0	6,248	-654	5,595
Caller Service	62	21,098	0	11	21,110	0	21,110
Money Orders	73	152,617	0	1,895	154,512	0	154,512
Post Office Box Service	74	634,193	0	452	634,645	-378,810	255,835
<b>Total Domestic Market Dominant Services</b>	<b>91</b>	<b>1,600,381</b>	<b>0</b>	<b>32,284</b>	<b>1,632,665</b>	<b>-368,526</b>	<b>1,264,139</b>
<b>International Market Dominant</b>	<b>159</b>	<b>985,255</b>		<b>1,228</b>	<b>986,483</b>		<b>986,483</b>
<b>Total Domestic Competitive Attributable Costs</b>	<b>192</b>	<b>13,940,824</b>	<b>19,448</b>	<b>400,762</b>	<b>14,361,034</b>	<b>590,008</b>	<b>14,951,042</b>
<b>International Competitive</b>	<b>179</b>	<b>980,591</b>		<b>436</b>	<b>981,027</b>		<b>981,027</b>
<b>Total Competitive</b>	<b>197</b>	<b>14,921,415</b>	<b>19,448</b>	<b>429,151</b>	<b>15,370,014</b>	<b>590,008</b>	<b>15,960,022</b>

There was only one active market dominant NSA last year (in FY 2018), but it created the need to address costs for three “product types” within USPS Marketing Mail. As noted above, the inframarginal costs relating to those “product types” were estimated using a proxy driver method. In FY 2019, however there were no market dominant NSAs, and therefore no NSA results are summarized in the table below. The inframarginal costs for Non-Profit, used in folder USPS-FY19-27, however, are shown in this table.

**Table 2. IC Summary Report for USPS Marketing Mail Non-Profit**

<i>Component Name</i>		Vol Var / Prod Spec Cost	Inframarginal	Incremental Cost
<i>Source/Notes</i>		USPS-FY19-31	Col.3 - Col. 1	
		USPS-FY19-27, 30		
	Columns	(1)	(2)	(3)
<b>USPS MARKETING MAIL NON-PROFIT</b>				
Non-Profit High Density and Saturation Letters	134	42,560	19	42,579
Non-Profit High Density and Saturation Flats and Parcels	135	87,720	86	87,806
Non-Profit Carrier Route	133	144,403	62	144,465
Non-Profit Letters	130	1,049,763	4,616	1,054,379
Non-Profit Flats	131	686,905	457	687,362
Non-Profit Parcels	132	36,243	1	36,245

**Table 3. IC Summary Report for Market Dominant Post Office Box Services**

<i>Component Name</i>		Vol Var / Prod Spec Cost	Inframarginal	Incremental Cost
<i>Source/Notes</i>		USPS-FY19-NP13	Col, 3 - Col. 1	
		USPS-FY19-NP26,NP27		
	Columns	(1)	(2)	(3)
<b>PO BOXES</b>				
Market Dominant PO Box	135	255,384	72	255,456

**Revisions of 01/10/2020:** Revisions of this date reflect changes made to the ICRA (USPS-FY19-NP2), also of this date. ICRA costs have changed for certain International products, with offsetting changes of approximately \$346 thousand between total Market Dominant and Competitive mail. The change in cost identified in USPS-FY19-NP2 occurs in International Transportation (component number 146), which is 100 percent volume variable, and thus has no effect on inframarginal cost. The revised version of FY2019Public.IC SummaryReport.xlsx included within this revised folder has been updated to show the shift in volume variable cost between Market Dominant and Competitive International mail. As necessary, values in tables within this Preface have been updated to reflect the revisions, which results in slightly smaller Incremental Costs for Total Competitive as shown on the revised Summary Report (page 6). Rows with changed values are highlighted in gray.